The Hotel Industry

THE HOTEL INDUSTRY IN HAMPTON ROADS

A hotel isn't like a home, but it's better than being a house guest.

– William Feather (American business author, d. 1981)

Real estate professionals often divide the commercial real estate market into five sub-markets: (1) Multifamily Housing, (2) Office Space, (3) Industrial Space, (4) Retail Space and (5) Hotels and Casinos. In this chapter, we focus on the hotel market, which is in a state of flux because of economic recession.

There are two primary ways to analyze the health of the hotel industry. The first is to undertake a macro-level examination of revenue trends for the industry as a whole. Graph 1 does so by displaying the historical trend of total hotel revenue in Hampton Roads from 1988 to 2008. **One can see that regional hotel revenue more than doubled, from $355 million in 1988 to $718 million in 2007, a healthy upward surge of 102 percent. However, hotel revenue declined in 2008 to $680 million (-5.3 percent), due to increased gasoline prices observed during the first eight months of 2008, slightly higher average room rates and the economic recession that took firm hold in fall 2008.**

The hotel industry in Hampton Roads has been getting larger, at least in terms of the number of rooms available for rental. Between 1988 and 2007, the number of hotel rooms in our region increased by 25.4 percent (see Graph 2). Further, in 2008, the number of rooms grew by another 1,000 to a total of 38,000.

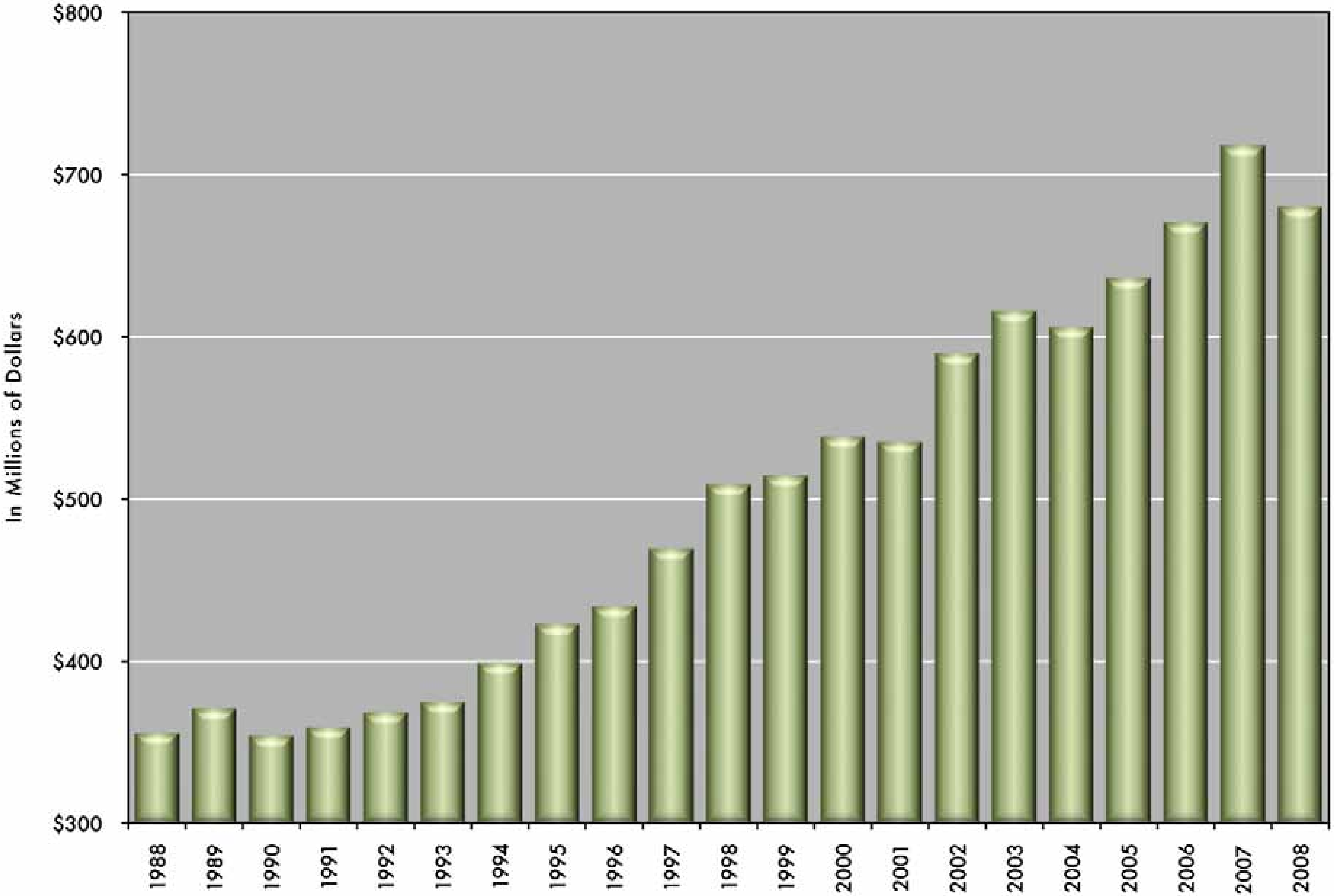
The second major way to analyze the economics of the hotel industry is to take a micro-level approach and focus upon individual hotels. This approach usually looks at measures of single-hotel performance, such as a hotel's room occupancy rate, the average daily revenue it receives per occupancy (ADR) and the revenue it generates per available room (REVPAR).

A hotel's occupancy rate is straightforward – the ratio of room nights rented to the number of rentable room nights it has available. ADR is the average room rate collected by a hotel. REVPAR combines these two measures and is the ratio of hotel revenue received during a specified period of time to the total number of room nights available to rent during the same period. It is the preferred measure of the economic performance of a hotel.

If two comparable hotels have the same REVPAR, then the hotel with a lower occupancy rate usually is viewed as having a better performance. There are two reasons for this. First, the operating costs of a hotel will be less for the hotel with the lower occupancy rate. Such a hotel doesn't have to incur as many costs in order to attain a given REVPAR. Second, many hoteliers believe it is easier to drive up their revenue by paying for additional advertising and marketing that results in greater occupancy than it is for them to augment revenue by raising prices. If competitors do not increase their room rates at the same time, then a single hotel that increases its room rates likely will encounter problems.

GRAPH 1

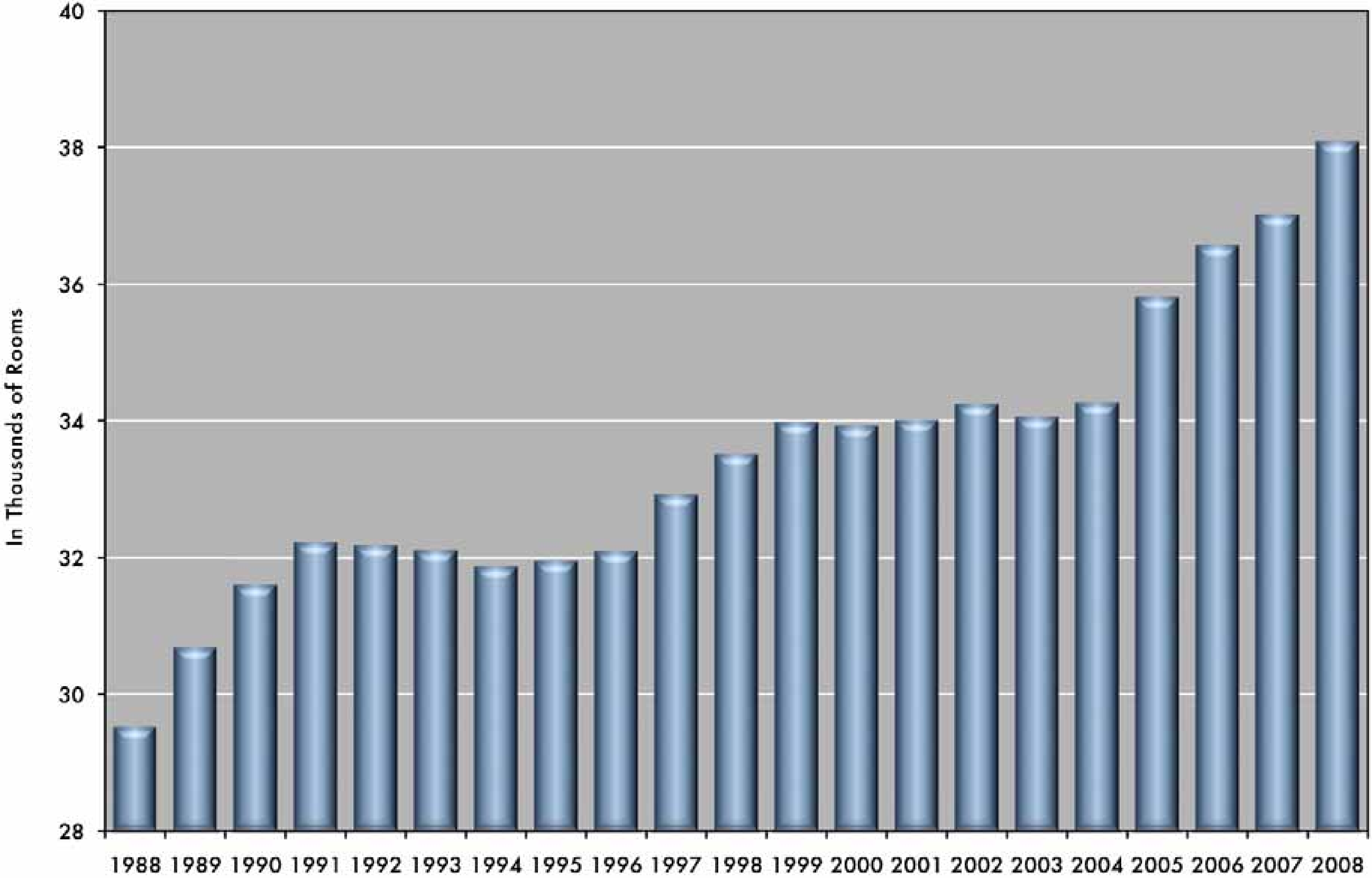
TOTAL HOTEL REVENUE IN HAMPTON ROADS, 1988 TO 2008



Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

GRAPH 2

NUMBER OF HOTEL ROOMS IN HAMPTON ROADS, 1988 TO 2008



Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

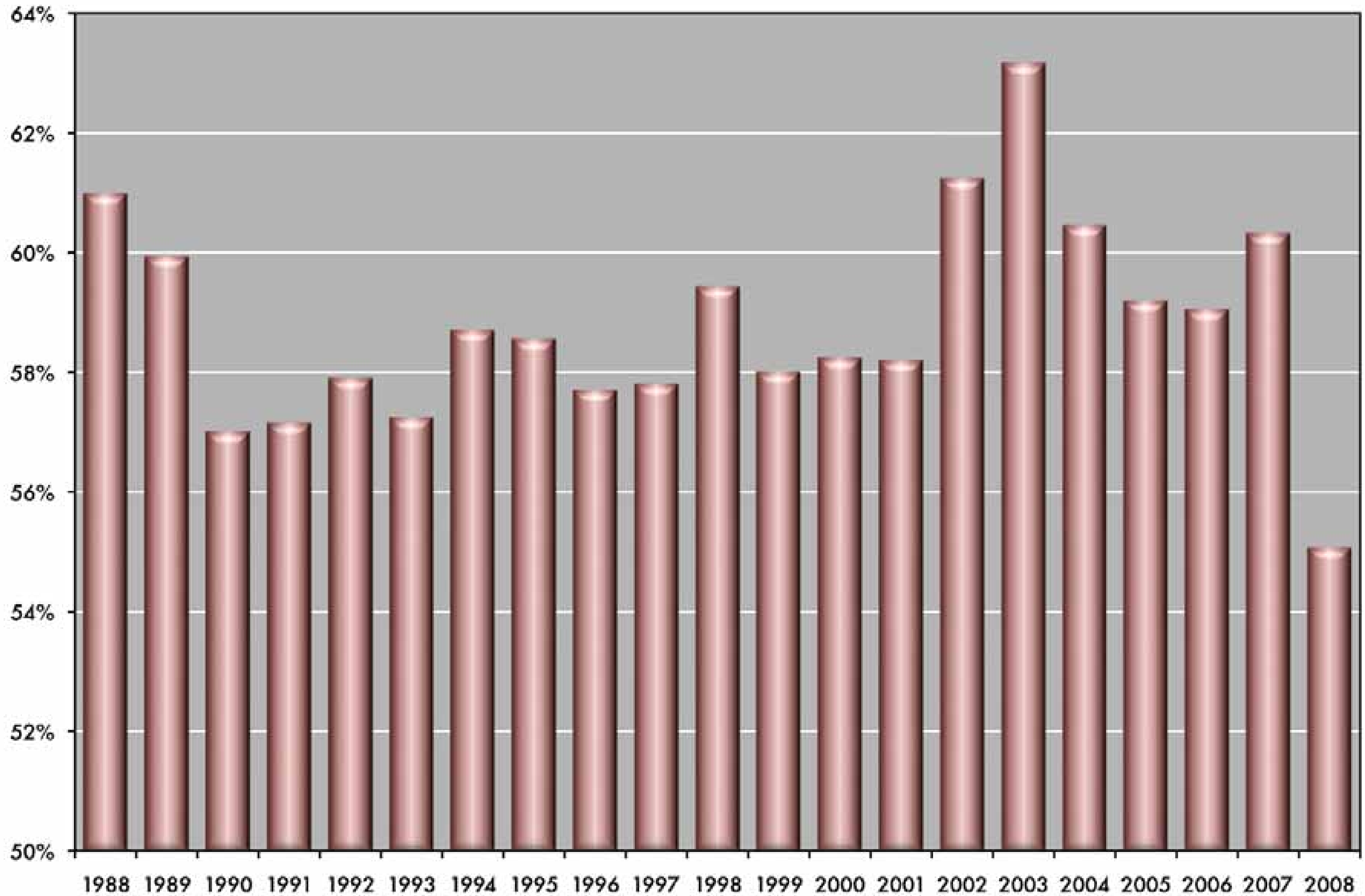
Graphs 3 through 5 record the occupancy rates, ADR and REVPAR for hotels in Hampton Roads between 1988 and 2008. **Hotel occupancy rates (Graph 3) have fluctuated between 55 percent and 63 percent over the past two decades, with the average occupancy rate being 59 percent. Nevertheless, in 2008, occupancy rates fell to a much lower level, 55.1 percent.** The villains appear to be higher gasoline prices, slightly higher average room rates, deteriorating economic conditions and the addition of 1,000 hotel rooms in the region.

Graphs 4 and 5, respectively, show ADR and REVPAR between 1988 and 2008. Note that ADR (average room revenue) increased in all but three years during that time, and even increased slightly in 2008. As Graph 4 illustrates, ADR increased 64 percent during this two-decade time period. However, REVPAR (revenue earned per available room) has been much more variable and declined in about one-third of those years. The REVPAR for the typical hotel in the region took a steep fall in 2008, primarily due to the decline in occupancy that we noted above (see Graph 5).

The Old Dominion University Forecasting Team projects a decline of 2.2 percent in total hotel revenue in Hampton Roads in 2009. This will be compounded by the fact that yet an additional 877 hotel rooms could potentially open in Hampton Roads in 2009. Needless to say, this does not bode well for the profitability of the hotel industry in the region because a smaller revenue pie will be divided among a larger number of rooms and operators. We expect REVPAR to decline further, to about $47 in 2009, a level not seen since 2002.

GRAPH 3

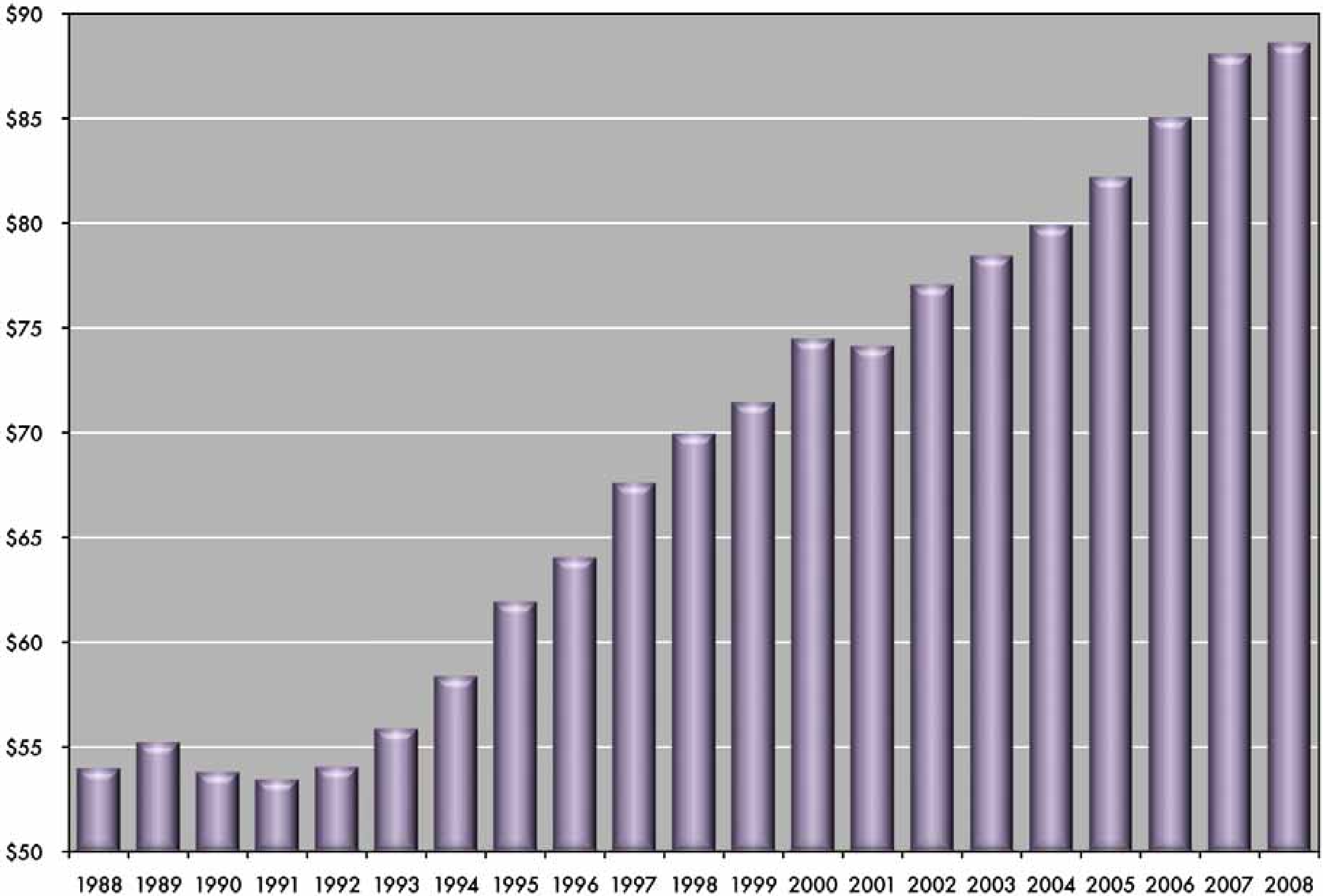
OCCUPANCY RATES OF HOTELS IN HAMPTON ROADS, 1988 TO 2008



Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

GRAPH 4

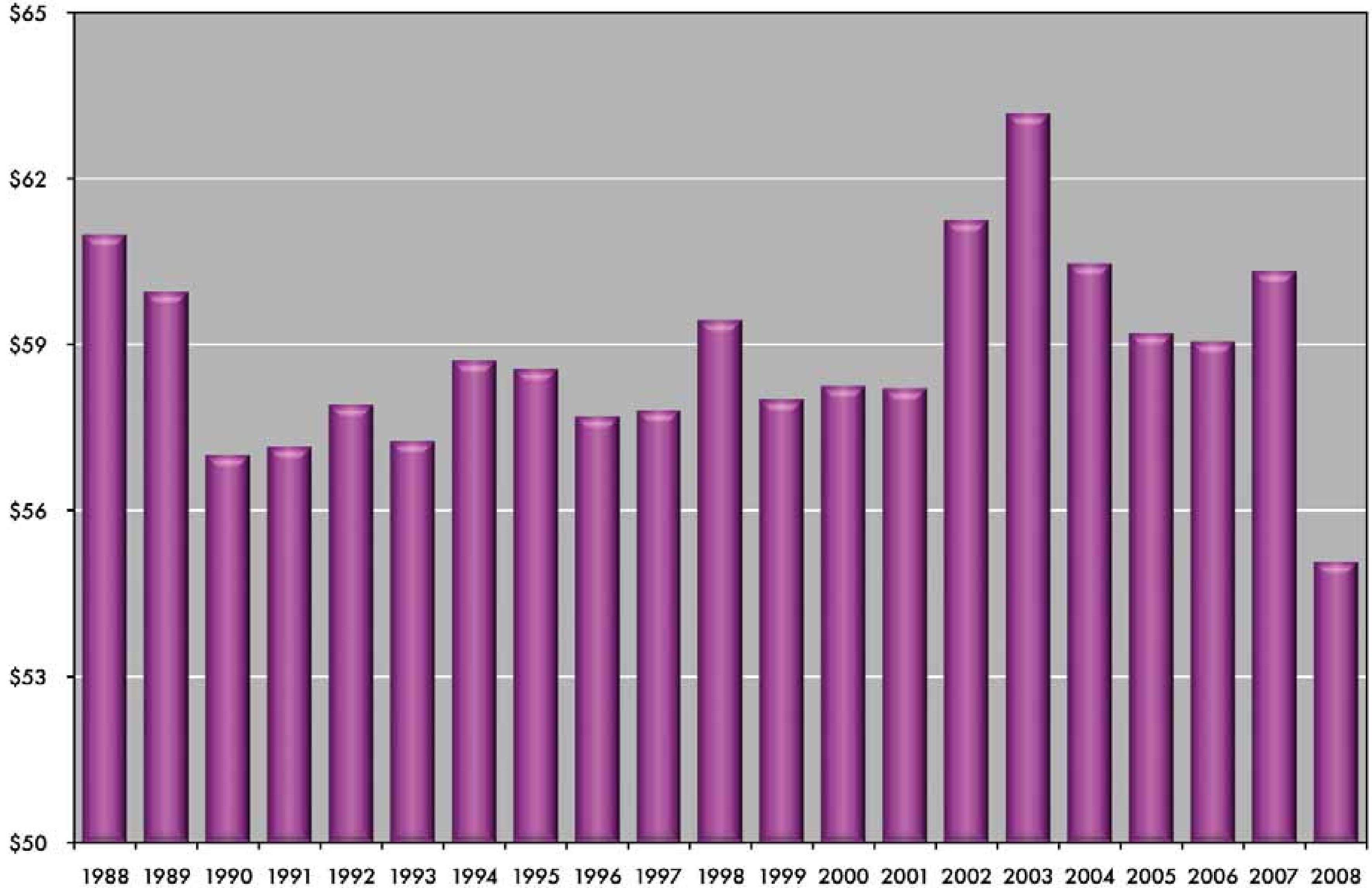
AVERAGE DAILY RATE OF HOTELS IN HAMPTON ROADS, 1988 TO 2008



Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

GRAPH 5

REVENUE PER AVALIABLE ROOM FOR HOTELS IN HAMPTON ROADS, 1988 TO 2008



Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

Comparing Hampton Roads to Other Metropolitan Areas

Let's accept as a given that the hotel industry in Hampton Roads currently is facing significant economic challenges. How are we doing relative to comparable metropolitan areas? Tables 1 and 2 provide information in that regard for the years 1988 to 2007, and 2007 to 2008, respectively.

It is evident from Table 1 that the hotel industry in Hampton Roads is much larger than any of those in the other five Atlantic Coast metropolitan areas drawn for comparison. In fact, the hotel industry in our region is 52 percent greater than its next largest competitor, Jacksonville, in terms of total annual hotel revenue earned. From 1988 through 2007, our average annual hotel revenues totaled $491.8 million, more than double those generated in Richmond.

During this approximate two-decade time period, Hampton Roads offered, on average, 33,220 rooms, 42 percent more than the next largest market in this regard (Charlotte). Nevertheless, we also can see that the growth in total hotel revenues easily was the smallest in Hampton Roads compared to the other five regions. Between 1988 and 2007, hotel revenues in Hampton Roads grew by 102 percent, while they increased 312 percent in Charleston and more than 250 percent in both Charlotte and Raleigh-Durham-Chapel Hill.

One also can see in Table 1 that the Charlotte metropolitan area led the pack insofar as adding additional hotel rooms was concerned. No doubt this spurt has been tempered by the serious economic problems the city's major banks have encountered over the past year.

In addition, the average occupancy rate of hotel rooms in Hampton Roads was lower than the rates of all five of the other metropolitan regions (59 percent compared to Charleston's leading 67 percent).

REVPAR, an important key to hotel industry health, also lagged in Hampton Roads and grew only 61.5 percent. The highest growth (139.5 percent) occurred in the Charleston market.

TABLE 1

COMPARING AVERAGE HOTEL INDUSTRY PERFORMANCE: HAMPTON ROADS AND OTHER METROPOLITAN AREAS, 1988-2007

Measure	Hampton Roads, VA	Jacksonville, FL	Charlotte, NC	Raleigh, NC	Charleston, SC	Richmond, VA
Hotel Industry Revenue (Average)	$491.8 M	$323.9 M	$311.1 M	$282.2 M	$246.2 M	$208.3 M
Hotel Rooms (Average)	33,220	19,939	23,466	18,848	12,678	15,821
Change in Hotel Revenue	102.0%	222.0%	267.8%	260.0%	311.5%	163.1%
Change in Hotel Rooms	25.4%	50.3%	95.0%	72.4%	72.3%	47.1%
REVPAR (Average)	$40.2	$43.1	$35.3	$39.9	$51.2	$35.3
Change in REVPAR	61.5%	114.8%	89.1%	109.4%	139.5%	79.3%
Occupancy Rate (Average)	59.0%	63.6%	59.2%	64.0%	67.0%	60.6%

Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

Of course, economic conditions have changed substantially in the past two years. Among other developments, housing markets deteriorated substantially, gasoline prices spiked during summer 2008, and the economy plunged into a recession that now has been dated as beginning in December 2007. All of these events adversely affected the hotel industry in Hampton Roads and Table 2 shows how. Regional hotel revenue declined by 5.3 percent in 2008, our occupancy rate fell by 8.7 percent and REVPAR decreased by 8.1 percent.

All in all, 2008 was not a good year for the hotel industry in Hampton Roads. Further, the hotel industry here fared worse than in the other five Atlantic Coast metropolitan areas in our comparisons. In Table 2, one can also see that total hotel revenue, REVPAR and occupancy all declined more in Hampton Roads in 2008 than in any of the other five metro areas.

That generalization, however, hides some interesting differences during 2008 and does not speak to 2009, which has been agreeably different. Let's see how.

The highly publicized crisis in the banking system accelerated dramatically in the public consciousness in September 2008. It's useful, therefore, to compare what happened to the hotel industry prior to Sept. 1 to what occurred after that date. And, to put this in perspective, let's compare those time periods in 2008 to the identical time periods of 2007.

Table 3 reveals that in contrast to Hampton Roads, total hotel revenue actually increased in three of the other five markets, while REVPAR increased in one of these markets. Occupancy rates fell noticeably in all five of the other markets. Thus, for the first eight months of 2008, the hotel industry deteriorated more rapidly in Hampton Roads than in these other regions.

Table 4 undertakes the same type of analysis, but focuses on the Sept. 1 to Dec. 31 time period. Once again, 2008 is compared to 2007 in Hampton Roads and the other five metropolitan areas. One can see that the differences between Hampton Roads and the other regions moderated substantially, and in one case (occupancy rates), Hampton Roads no longer was last.

Things began to change, however, in 2009. During the first three months of 2009, Hampton Roads experienced the smallest declines in hotel revenue, REVPAR and occupancy rates of any of the regions in our comparison. By way of illustration, REVPAR declined 7.6 percent in Hampton Roads, but between 17.1 percent and 21.7 percent in the other five regions (see Table 5). It would be a misnomer to label this a recovery for the Hampton Roads hotel industry since all of our region's critical numbers are negative. Even so, it is correct to observe that hotels in Hampton Roads now are weathering this economic contraction much better than the hotels in comparable metropolitan areas along the Atlantic Coast. Of the other five regions, Charlotte appears to be suffering the most. This is not surprising, given the demise of Wachovia Bank and the teetering financial circumstances of Bank of America, both of which are headquartered in Charlotte.

We observed at the beginning of this report that Hampton Roads has been less severely impacted by this economic recession than most other metropolitan areas in the United States. Indeed, a June 2009 study issued by the Brookings Institution Metropolitan Study Program reported that, economically speaking, Hampton Roads had fared 16th best among the 100 largest metropolitan areas in the country up to that point. It is apparent that the significant expenditures the Department of Defense makes within Hampton Roads have cushioned our economic descent. **In years past, some critics have faulted Hampton Roads for a lack of diversification in its economic base. More than 40 percent of our region's economy is related to defense spending. In the current economic milieu, however, this has turned out to be an important advantage. We are not as dependent upon private-sector business travel as other metropolitan areas, and this has diminished the economic damage done to our region's hotels and motels.**

TABLE 2

CHANGES IN REVENUE AND OCCUPANCY, 2007 TO 2008

Measure	Hampton Roads, VA	Jacksonville, FL	Charlotte, NC	Raleigh, NC	Charleston, SC	Richmond, VA
Change in Hotel Revenue	-5.3%	-3.0%	-2.6%	0.1%	-0.7%	-1.9%
Change in REVPAR	-8.1%	-7.8%	-3.5%	-2.5%	-4.9%	-5.7%
Change in Occupancy Rate	-8.7%	-7.5%	-8.1%	-5.7%	-7.7%	-8.5%

Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

TABLE 3

CHANGES IN REVENUE AND OCCUPANCY, JANUARY-AUGUST 2007 VERSUS JANUARY-AUGUST 2008

Measure	Hampton Roads, VA	Jacksonville, FL	Charlotte, NC	Raleigh, NC	Charleston, SC	Richmond, VA
Change in Hotel Revenue	-3.3%	-1.2%	0.9%	2.2%	3.5%	-0.3%
Change in REVPAR	-5.8%	-5.8%	0.2%	-0.3%	-1.2%	-3.1%
Change in Occupancy Rate	-7.2%	-6.7%	-6.2%	-4.5%	-5.8%	-7.0%

Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

TABLE 4

CHANGES IN REVENUE AND OCCUPANCY, SEPTEMBER-DECEMBER 2007 VERSUS SEPTEMBER-DECEMBER 2008

Measure	Hampton Roads, VA	Jacksonville, FL	Charlotte, NC	Raleigh, NC	Charleston, SC	Richmond, VA
Change in Hotel Revenue	-10.9%	-7.4%	-10.0%	-4.1%	-10.4%	-5.2%
Change in REVPAR	-14.4%	-12.5%	-11.2%	-7.2%	-13.5%	-10.9%
Change in Occupancy Rate	-12.2%	-9.1%	-12.4%	-8.2%	-12.2%	-11.5%

Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

TABLE 5

CHANGES IN REVENUE AND OCCUPANCY, JANUARY-MARCH 2008 VERSUS JANUARY-MARCH 2009

Measure	Hampton Roads, VA	Jacksonville, FL	Charlotte, NC	Raleigh, NC	Charleston, SC	Richmond, VA
Change in Hotel Revenue	-4.5%	-17.4%	-18.0%	-14.1%	-16.2%	-11.7%
Change in REVPAR	-7.6%	-21.7%	-20.3%	-17.1%	-17.5%	-18.6%
Change in Occupancy Rate	-4.5%	-13.9%	-16.8%	-12.4%	-10.8%	-16.5%

Sources: Smith Travel Research Trend Report, May 6, 2009, and the Old Dominion University Economic Forecasting Project

Summing It Up

These are difficult times for the hotel industry in Hampton Roads, though not quite as difficult as those being experienced by hotel owners in at least five other comparable metropolitan areas along the Atlantic Coast. All of the most important variables relating to hotel economics (total hotel revenue, average rates, revenue per room and occupancy rates) have been deteriorating. Despite these discouraging developments, an additional 1,000 hotel rooms were added in 2008 in Hampton Roads and another 877 hotel rooms currently are under construction. Hence, the regional hotel industry appears to be expanding its capacity at a time when the demand for its rooms has been declining.

Should these conditions continue, it is likely that marginal hotel operations will be forced out of the Hampton Roads market. Marginal here should be understood to mean unprofitable and does not connote expensive versus inexpensive hotels, or nationally branded hotels versus those that are not. A veteran real estate broker in Hampton Roads told us, "There is excess capacity now in hotel markets in Hampton Roads and this will drive the least capable operators out." This is a harsh conclusion, but one that actually could hasten recovery in the industry, if it comes to pass.